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C O N F I D E N T I A L SECTION 01 OF 02 TEGUCIGALPA 000302

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TREASURY FOR AFAIBISHENKO
STATE PASS AID FOR LAC/CAM
NSC FOR DAN FISK
COMMERCE FOR MSELIGMAN AND WBASTIAN
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E.O. 12958: DECL: 02/15/2017
TAGS: [EPET](#) [ENRG](#) [PREL](#) [BBSR](#) [NI](#) [VE](#) [HO](#)
SUBJECT: HONDURAN DEBATE ON FUELS LIBERALIZATION VS
NATIONALIZATION REACHING ENDGAME?

REF: A. A) TEGU 262

[1](#)B. B) TEGU 225 AND PREVIOUS

Classified By: AMB Charles Ford for reasons 1.5 (b,d)

[1](#)1. (C/NF) Summary: The GOH debate over fuels imports now appears to be on the brink of favorable resolution. Based on all our recent contacts with GOH officials, it is Post's assessment that the GOH no longer seeks nationalization of the fuels sector and is laboring mightily to find a mutually acceptable but face-saving exit to this situation. They view the mounting pressure to nationalize as a threat to their plans, and they seek a deal with the IOCs as soon as possible in order to avert a worsening of the situation. If the IOCs determine that this deal is in their best interests, and if they act with dispatch, Post expects the GOH could reach agreement with them in the next few days. On the other hand, if the companies cannot accept the deal, or the GOH gets cold feet, the nationalization and sole-source supplier plan remains waiting in the wings. End Summary.

[1](#)2. (C/NF) The GOH debate over fuels imports -- which began in October 2005 and reached its nadir on January 13, 2007, when the GOH announced plans to seize privately owned fuel storage facilities by force -- now appears to be on the brink of favorable resolution. In separate comments to the Ambassador and EconChief on February 13, GOH Minister Enrique Flores Lanza and GOH advisor on fuels Arturo Corrales both said President Jose Manuel "Mel" Zelaya Rosales was on the verge of reaching a deal with international oil companies currently operating in Honduras, rather than seeking to nationalize the fuels sector. As Post has reported extensively (reftels), Zelaya has been moving towards this decision since a January 18 meeting between Flores Lanza and the IOCs in San Salvador, in which it became clear that nationalizing imports would not save money. At that meeting the IOCs told Flores Lanza and Corrales that they are prepared to work with the GOH on reforming the state-run fuel-pricing scheme to make the market more competitive and more price-efficient.

13. (C/NF) Since that meeting, the GOH has met several times with each of the IOCs separately (Shell, Esso, and Texaco) to solicit proposals that would respect both the political needs of the GOH and the financial needs of the firms. Shell and Texaco reportedly made rapid progress in these talks, Esso much less so. By January 23 all firms had submitted proposals, and a series of informal talks ensued. It quickly became clear that Texaco and Shell were each close to tabling offers that both sides could accept. Esso, however, resisted modifications to its January 23 proposal and talks between that firm and the GOH bogged down. In their February 13 calls to Ambassador and EconChief, Flores Lanza and Corrales said, in effect, that if the companies would submit formal offers codifying the results of the last week's talks, the President would accept the deal and end the current crisis. Post has been in contact with the IOCs throughout this process, encouraging them to act promptly. Ultimately, we reminded them, it is the responsibility of the company to act in its own best long-term interests, whether that be to accept the deal on offer or to reject it. But, we stressed, if the IOCs intend to accept the offer, time is of the essence.

14. (C/NF) Opponents of market liberalization and proponents of nationalization of the sector (led by Juliette Handal of the Patriotic Coalition) have meanwhile been busy increasing public pressure on Zelaya to nationalize imports and sign a sole-source contract with U.S. firm ConocoPhillips to supply the GOH with all of Honduras' fuel imports for the year. According to both Corrales and Flores Lanza, Conoco on February 13 submitted a signed contract to the GOH that, while final, included a clause conditioning the deal on resolution of the fuel-storage issue. According to Flores Lanza, this represents no substantive change in Conoco's

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position, since Conoco has always conditioned its offer on the GOH demonstrating it has access to adequate and legally acquired storage facilities. Flores Lanza told EconChief that the GOH is not inclined to sign this contract, since it does not meaningfully move the deal towards closure and, in fact, could weaken the GOH's leverage to obtain access to those storage facilities. Nevertheless, news that Conoco had signed a contract would be a public relations coup for Handal and her supporters, who are sure to use it to try to sway public opinion in favor of prompt nationalization. Based on all our recent contacts with GOH officials, it is Post's assessment that the GOH no longer seeks such a nationalization and is laboring mightily to find a mutually acceptable but face-saving exit to this situation. They view the mounting pressure to nationalize as a threat to their plans, and they seek a deal with the IOCs as soon as possible in order to avert a worsening of the situation.

15. (C/NF) In the meantime, the GOH has also filed suit against DIPPSA, the Honduran owner of the fuel storage facilities in question. A clause in DIPPSA's operating license allows the GOH to use DIPPSA's facilities in times of emergency and with fair compensation to be paid to the firm. However, to date DIPPSA has declined to comply with that clause, prompting the GOH lawsuit for breach of contract. A straightforward affair, the judge quickly found for the GOH but could not enforce the judgment because DIPPSA owner Henry Arevalo has disappeared. Until he can be found and formally served, the process is on hold. The court could also appoint a custodian for DIPPSA, but that would be a slow process. (Comment: Post assesses that the lawsuit was intended both to keep pressure on the IOCs by keeping the Conoco alternative alive and to convince the Honduran public that the GOH is doing everything in its power to reduce fuel prices for the consumer. The GOH is also likely using the latter tactic to better defend itself from the coming attacks by Handal and others when the sole-source contract is not signed and the sector not nationalized. Finally, we assess that the lawsuit is also meant in part to pressure Arevalo personally, who has publicly defied President Zelaya. A

classic cacique (Latin strongman) who runs all policy personally, Zelaya likely views Arevalo's impudence as galling and intolerable. End Comment.)

¶6. (C/NF) If the IOCs determine that this deal is in their best interests, and if they act with dispatch, Post expects the GOH could reach agreement with them in the next few days. That would put Honduras on a path towards rapid liberalization of its fuels market and would set an important precedent by rolling back populist and quasi-socialist plans in favor of the free market. On the other hand, if the +Ub&~}DQ plan remains waiting in the wings. If the GOH takes this route, there is little more Post can do to prevent a likely series of sharply negative consequences, possibly including several lawsuits by the IOCs and claims of CAFTA violations. Post remains cautiously optimistic the GOH intends to choose liberalization, assuming the companies come forward soon with a mutually acceptable final offer.

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